

ST 99-18

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

"PAUL REVERE", as responsible officer of
"Guttenberg Printing, Inc.",

Taxpayer

98-ST-0000
0000-0000
NPL #0000

Mimi Brin
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Walter E. Trittipio on behalf of "Paul Revere"; Mr. Marc Muchin, Special Assistant Attorney General, on behalf of the Illinois Department of Revenue

Synopsis:

This matter comes on for hearing pursuant to "Paul Revere's" (hereinafter referred to as "Revere" or the "Taxpayer") protest of Notice of Penalty Liability No. 0000 (hereinafter referred to as the "NPL") issued by the Illinois Department of Revenue (hereinafter referred to as the "Department") to "Revere" as a responsible officer of "Guttenberg Printing, Inc." (hereinafter referred to as the "Corp.") for the period of 7/92-6/95, 9/96 and 4/97 (hereinafter referred to as the "Tax Period"). The issue for hearing is whether "Revere" was an officer or employee responsible for the filing of Retailers' Occupation and related tax returns and making the payment of the taxes due thereon and

whether he wilfully failed to file and/or pay those to the State. "Revere" appeared and testified on his own behalf. The testimony of Mr. "Sam Adams" is had through his evidence deposition.¹ Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department except for the liability for 4/97. In support of this recommendation, I make the following findings of fact and conclusions of law:

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of the Notice of Penalty Liability No. 0000 for the tax years 7/92-6/95, 9/96 and 4/97 issued to "Paul Revere". Department Ex. No. 1
2. The basis of the NPL is the Retailers' Occupation Tax (35 ILCS 120/1 *et al*) and Use Tax (35 ILCS 105/1 *et seq.*)(hereinafter collectively referred to as the "ROT") liability of "Guttenberg Printing, Inc.", an Illinois corporation, located in Illinois. Department Ex. No. 1; Taxpayer Ex. Nos. 2, 3
3. At all pertinent times, "Revere" was the Chief Executive Officer of the corp. (Tr. pp. 9-10, 63-64) as well as 100% shareholder. Tr. pp. 59, 63
4. The Department's audit of the corp. began in April, 1995. Tr. p. 10; Taxpayer Ex. No. 4 (evidence deposition), p. 11
5. "Revere" directed the corp.'s Chief Financial Officer, Mr. "Sam Adams" (hereinafter referred to as "Adams"), to handle the audit. Tr. pp. 10-11; Taxpayer Ex. No. 4, p. 12

¹ Taxpayer Ex. No. 4 is the transcript of the evidence deposition admitted into evidence.

6. "Revere" appointed and promoted the corp. officers, including "Adams", who reported to him. Tr. pp. 49, 51, 52 "Adams" did his job as CFO from January, 1992 until the corp. went into bankruptcy on May 14, 1997 (Taxpayer Ex. No. 4, pp. 10, 30, 46) and "Revere" had total trust in him. Tr. p. 72
7. "Revere" delegated to "Adams" the duty to determine debt payment (Tr. pp. 56-57) and, as delegated by "Revere", "Adams" had the sole authority to sign corp. checks beginning from the fall of 1995. Taxpayer Ex. No. 4, p. 33 Although "Revere" concedes that he had authority to sign checks until October, 1995 (Tr. p. 36) there is no sufficient evidence of record that he did not continue to have that authority thereafter.
8. Retailers' Occupation Tax returns were prepared in-house by the accounting department, with information from accounting records. Taxpayer Ex. No. 4, p. 53
9. "Adams" was in charge of the in-house controllers and accounting staff. *Id.*
10. "Adams", as CFO, signed, in January, 1997, the EDA-105 Audit Reports which were presented to him as a result of the Department audit. Taxpayer Ex. No. 2, 3
11. In October, 1995, the cost of paper had dramatically escalated and the corp.'s customers began cutting back on their orders. Tr. pp. 11-13

12. As a result of the reduction in the value of the corp.'s inventory and the reduction in business orders, the corp.'s line of credit was affected, as the banks would no longer loan the corp. money for inventory purposes. Tr. pp. 14-15 This continued from October, 1995 through 1996. Tr. p. 15
13. In response to its depressed economic condition, there was an attempt to sell the business. Tr. p. 16
14. Toward this end, a consultant, "Think Fast Associates", was hired in June or July, 1996. Tr. p. 16
15. In December, 1996, "Revere", on behalf of the corp. as well as on behalf of himself, individually, entered into a "Proposed Asset Acquisition" with "Merger Management Group, Inc." (hereinafter referred to as "Merger") (Taxpayer Ex. No. 1) wherein "Merger" proposed, *inter alia*, to purchase certain corp. equipment from creditors holding liens thereon, to purchase those corp. assets liened by the (unnamed) Bank, to purchase real estate housing the corp., and to employ "Revere" as a salesman for a five year period. *Id.*; Tr. pp. 17-19
16. Until a more definite agreement was reached, the Proposed Asset Acquisition agreement could be terminated by either party at any time. Taxpayer Ex. No. 1, p. 4 This document did not create any binding obligation, commitment or liability on the part of "Merger" or "Revere", until a definitive agreement was executed. *Id.*
17. While "Merger" was involved with the corp. in doing its due diligence to determine whether to finalize its proposed asset purchase, "Revere" knew

that payments on equipment were not being made, there was no business because the presses were not running, and personnel were laid off. Tr. p. 27

18. Before "Merger" was involved with the corp., "Adams" spoke with "Revere" on a daily basis regarding finances. Taxpayer Ex. No. 4, p. 52
19. After and during "Merger's" involvement with the corp., "Adams" did not specifically discuss the ROT returns with "Revere" (Taxpayer Ex. No. 4, p. 67) although during 1996, "Revere" did ask "Adams", frequently, about how the Department audit was going. *Id.* at 67-68
20. "Merger" did not purchase the corp. and terminated its interest in it around March, 1997. Another Illinois printing company, "Block Letter, Inc.", began auditing corp. books as a possible purchaser at the same time. Tr. pp. 28-29 "Block Letter" did not purchase the corp. Tr. p. 31
21. "Block Letter" left the corp. at about the end of April, 1997, and in the first week of May, 1997, "Revere" was advised by "Adams", who was still the corp. Chief Financial Officer, that payroll, payroll taxes, health insurance and the Illinois Department of Revenue all had to be paid. Tr. pp. 33-34; Taxpayer Ex. No. 4, p. 73; Taxpayer Ex. Nos. 2, 3
22. The corp. filed a bankruptcy petition on May 14, 1997. Tr. p. 41
23. Prior to the bankruptcy, there was money available to pay the taxes the Department represented as due from the corp. following the audit. Tr. pp. 46, 47

24. In 1992, 1993, and 1994, "Revere's" salary from the corp. was \$390,000 per year. Tr. pp. 68-69 In 1995 and 1996, his salary was \$100,000 per year. *Id.* In 1997, his salary was \$88,000. *Id.*

Conclusions of Law:

Illinois law provides that the Department may assess a tax penalty against certain individuals for the unpaid Retailers' Occupation Tax liability of a retail corporation. 35 ILCS 735/3-7² This liability, which survives the dissolution of the corporation, attaches to:

- (a) Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who wilfully fails to file the return or make the payment to the Department or wilfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon.

Id.

It is clear that personal liability is imposed on one who is "responsible" for the filing of ROT returns and for the payment of the taxes shown to be due thereon, and who "wilfully" fails to file and/or pay such taxes. The statute defines neither "responsible" person nor "wilful" conduct. However, the Illinois Supreme Court, in cases wherein it considered personal liability, has referred to interpretations of similar language in section

² Effective January 1, 1994, the personal liability penalty is found in the Uniform Penalty and Interest Act. 35 ILCS 735/3-1 *et seq.* Prior to that date, it was found in section 13½ of the Retailers' Occupation Tax Act. Ill. Rev. Stat. ch. 120, par 452½ Pursuant to Sweis v. Sweet, 269 Ill. App.3d 1 (1st Dist. 1995), the pertinent personal penalty liability statute is the one in effect at the time the underlying corporate liability arose. See also, 35 ILCS 735/3-9(b) ("Penalties shall be imposed at the rate and in the manner in effect at the time the tax liability became due.") The corporate liabilities herein begin in 1992 and extend into 1996. Thus, both statutory provisions control. However, for all purposes necessary to this recommendation, the penalty provisions are the same. Therefore, in this recommendation, I shall cite to the Uniform Penalty and Interest Act provision.

6672 of the Internal Revenue Code (26 U.S.C. §6672), which imposes personal liability on corporate officers who wilfully fail to collect, account for, or pay over employees' social security and Federal income withholding taxes. Branson v. Department of Revenue, 168 Ill.2d 247 (1995); Department of Revenue v. Heartland Investments, Inc., 106 Ill.2d 19 (1985); Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill.2d 568 (1977)

Federal courts have addressed officer/employee liability with respect to who is considered "responsible" for §6672 purposes. They have considered specific facts in determining whether individuals were "responsible" for the employee taxes, to wit: 1) the duties of the officer as outlined by corporate by-laws; 2) the ability of the individual to sign checks of the corporation; 3) the identity of the officers, directors, and shareholders of the corporation; 4) the identity of the individuals who hired and fired employees; and, 5) the identity of the individuals who were in control of the financial affairs of the corporation. Monday v. United States, 421 F.2d 1210 (7th Cir. 1970), *cert. den.* 400 U.S. 821 (1970); Gephart v. United States, 818 F.2d 469 (6th Cir. 1987); Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990)

Responsible persons may include officers who can borrow money on behalf of the corporation (Peterson v. United States, *supra*), and may be those with check writing authority who may or may not be the ones with the responsibility for accounting, bookkeeping or the making of payments to creditors. Monday v. United States, *supra*; Wright v. United States, 809 F.2d 425 (7th Cir. 1987); Calderone v. United States, 799 F.2d 254 (6th Cir. 1986) There may be more than one responsible person in a

corporation. Monday v. United States, *supra*; Williams v. United States, 931 F.2d 805, 810 n.7 (11th cir. 1991)

Using the criteria followed by courts in addressing officer liability for taxes, "Revere" is a "responsible" officer for all of the tax period. At all times, he was the 100% corp. shareholder. At all times, he maintained the title of Chief Executive Officer. He hired and promoted personnel, and, it is reasonable to assume that he could also fire employees. "Revere" is the person who delegated to employees the scope of their authority. He had check signing authority even if he chose not to exercise same. He clearly had the right to make financial decisions for the corp. since it was "Revere" that entered into agreements and gave consent to various entities to come into the business and examine its books in an effort to sell it.

Taxpayer argues that sometime in October or November, 1996, "Merger" took over corp. operations, relegating him to a salesman position, without any other authority. However, if this was the case, it was not as a result of any contractual arrangement. Rather, "Revere" chose to allow "Merger" any authority it exercised, and, decided that he would work as a salesman, in the hope that "Merger" would purchase the business. He was aware that personnel were fired during this time and that payments were not being made on equipment. There is no evidence that persuades that "Revere" did not have access of all corp. books and records during this period, or that he could not continue to speak to "Adams" about corp. finances during this time. Because no contract exists which gave "Merger" the right to act in "Revere's" stead on these matters, the fact that he did not intervene during "Merger's" presence is based solely on his election not to do so.

The same is true for the short period that "Block Letter, Inc." was present at the business. These elections do remove him as a responsible person for purposes of these state taxes.

"Revere" effectuated the corp.'s bankruptcy filing in May, 1997. There was a short period of time between "Block Letter, Inc." advising that it would not purchase the business and this filing. "Revere" remained as Chief Executive Officer and 100% shareholder during this time, also. In fact, it is during this period, that he avers at hearing that he directed "Adams" to tell the bank to pay the taxes at issue herein, and that, to his knowledge there were funds sufficient for that purpose. Certainly, he was a responsible officer during this time.

As to the wilful element, Illinois courts have provided guidance for its determination beginning with Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill.2d 568 (1977) and culminating in Branson v. Department of Revenue, 168 Ill.2d 247 (1995). In effect, the Illinois Supreme Court accepts as indicia of wilfulness a showing of "reckless disregard for obvious or known risks" as set forth in cases dealing with section of 6672 of the Internal Revenue Code. Branson v. Department of Revenue, *supra*; Department of Revenue v. Heartland Investments, 106 Ill.2d 19, 29 (1985); Monday v. United States, 421 F.2d 1210, 1215 (7th Cir. 1987) In the case of Wright v. United States, 809 F.2d 425, 427 (7th Cir. 1987), the Seventh Circuit Court of Appeals stated that:

But bearing in mind that if a high degree of recklessness were required the purpose of the statute would be thwarted, just by compartmentalizing responsibilities within a business (however small) and adopting a "hear no evil-see no evil" policy, we think gross negligence is enough to establish reckless disregard. Concretely we hold that the 'responsible person' is liable if he (1) clearly ought to have known that (2) there was a grave risk that

withholding taxes were not being paid and if (3) he was in a position to find out for certain very easily.

This statement is reflective of federal court determinations which consistently find that wilfulness may be established with a showing that the “responsible party clearly ought to have known of a ‘grave risk of nonpayment’ and who is in a position to easily find out, but does nothing.” Branson v. Department of Revenue, *supra* at 255 (citing Ruth v. United States, 823 F.2d 1091 (7th Cir. 1987)) Further, it is without contest that “[w]ilfulness is present if the responsible person had knowledge of the tax delinquency and knowingly failed to rectify it when there were available funds to pay the government.” Gephart v. United States, *supra* at 475

Wilfulness also includes “failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government.” Peterson v. United States, *supra* at 1217 A person acts wilfully “when after he or she gains actual knowledge that the taxes are delinquent, liquid funds are available from which the taxes can be paid and he or she, having the ability to pay the taxes, fails to do so.” *Id.* at 1216 And, a person acts wilfully in failing to pay delinquent taxes if he prefers other creditors to the State. Department of Revenue v. Heartland Investments, *supra*; Calderone v. United States, *supra*

"Revere" is guilty of all of the above. He concedes that he was aware that while "Merger" was at the business, equipment was not being paid for. He also knew, during this time, that the Department was conducting an audit of the corp. and he had designated "Adams" to deal with it. Although "Revere" avers that he was relegated to the rank of salesman after "Merger" came in, that was by his choice, as the parties never entered into a contract wherein he was removed from his office as Chief Executive Officer or

whereby he relinquished his 100% shareholder position. Further, if he did not continually speak to "Adams" regarding the Department audit or other financial matters, he did so by choice, as there is nothing of record that shows that "Adams" could not speak to "Revere" about finances.

What is more important is the fact that in the first week of May, 1997, after "Block Letter, Inc." left the business premises, and before bankruptcy was filed, "Revere" was advised by "Adams" that payroll, payroll taxes, health insurance and taxes due to the Department had to be paid. Rather than write the check to the Department and sign it or direct "Adams" to sign it, the evidence is that "Revere" asked "Adams" to tell the bank to pay this liability (Tr. pp. 33-34) with the result being that of these liabilities, only the payroll and payroll taxes were apparently paid.

The Notice of Penalty Liability issued herein against "Revere" establishes the Department's *prima facie* case that he was a responsible officer who wilfully failed to pay taxes due from the corp. Branson v. Department of Revenue, *supra* The burden then shifts to the taxpayer to overcome the presumption of liability through sufficient evidence that the person was either not a responsible office or employee, or that his actions were not wilful. *Id.* "Revere" knew the corp. had a liability to the Department for unpaid taxes at a time that he says money existed to pay this debt.³ He directed his Chief Financial Officer to talk to the bank, which he professes was controlling corp. activities at this time, about paying the Department. It is based upon this direction, as well as the averments that he had no control over corp. finances, that "Revere" professes that he did not act in a

³ The record is unclear as to whether there was money available prior to and/or during the bankruptcy to cover the liability to the Department. "Revere" testified originally that there was money available prior to the bankruptcy (Tr. p. 46) but then he stated that the bank had to approve any payment. Tr. p. 47 No

wilful manner in this matter. However, courts have simply not allowed this defense to win the day. As mentioned, *supra*, a responsible person cannot escape his obligation as Chief Executive Officer and 100% shareholder by delegating responsibilities to others. Aside from his own testimony and the deposition testimony of "Adams", "Revere" presented no documentary evidence to support his contention that he legally lacked any authority to deal with the corp.'s tax liability. It is because of this failure, that he has not overcome his burden to sufficiently prove that he was not a responsible and wilful person for purposes of the personal penalty statute.

Although no documentation was presented, the Department did not challenge the assertion that the corp. filed bankruptcy on May 14, 1997. The ROT liability for April, 1997, as set forth on the NPL (Department Ex. No. 1), was due to be filed and paid after this filing. Therefore, "Revere" did not wilfully fail to file or pay that month's ROT liability.

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Penalty Liability issued against Paul "Revere", at issue herein, be amended to cancel the liability for April, 1997, and, as so amended, be finalized.

7/14/99

Mimi Brin
Administrative Law Judge

documentation was provided to support the testimony that prior to the bankruptcy filing, corp. payments needed bank approval.